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New Loan-Restructuring Scheme

Why in news?

The Reserve Bank of India gave the green signal to a loan-restructuring scheme for stressed borrowers.

What is the scheme?

- This scheme is a special window that provides one-time loan restructuring to companies and individuals.
- It will provide relief specifically to those impacted by the pandemic.

Who will benefit from the scheme?

- Only those companies and individuals whose loans accounts are in default for not more than 30 days as on March 1, 2020, are eligible.
- For **corporate borrowers**, banks can invoke a resolution plan till December 31, 2020 and implement it till June 30, 2021.
- Such loan accounts should continue to be standard until the date of invocation.
- The one-time restructuring window is available across sectors.

- The companies that were already in default for more than 30 days as on March 1 cannot avail this facility.
- This could affect revival plans of companies that were about to regain profitability but were hit when the lockdown was imposed.

- For **personal loans**, the resolution plan can be invoked until December 31, 2020 and will be implemented within 90 days thereafter.

How will it be implemented?

- The RBI has set up a five-member expert committee headed by K V Kamath.
- This committee will make recommendations on the financial parameters required.
- It will recommend the sector-specific benchmark ranges for such parameters to be factored into each resolution plan for borrowers with an exposure of Rs

1,500 crore or above at the time of invocation.
- It will also undertake a process validation of resolution plans for accounts above a specified threshold.
- The RBI will notify this along with modifications in 30 days.
- This means the RBI will have the last word on who will be eligible and the parameters.
- As per the RBI, the most adversely affected sectors by the pandemic are tourism and hospitality, construction and real estate, and aviation.

How will the scheme impact banks?

- The biggest impact will be that banks will be able to check the rise in non-performing assets (NPAs) to a great extent.
- However, it will not bring down the NPAs from the present levels.
- Banks will not face much of a problem in working out individual resolutions plans.
- But they will have to tackle borrowers who were in stress after the pandemic hit.

Were earlier such schemes not misused by banks and corporates?

- **Strategic Debt Restructuring (SDR) scheme** - Banks were given an opportunity to convert the loan amount into 51% of equity.
- This equity was to be sold to the highest bidder, once the firm became viable.
- This was unable to help banks resolve their bad loan problem as only two sales have taken place through this measure due to viability issues.

- **Sustainable Structuring of Stressed Assets scheme -** Banks were unwilling to grant write-downs as there were no incentives to do so.
- Write-downs of large debtors could exhaust banks' capital cushions.

- **Asset reconstruction scheme** - The major problem was that asset reconstruction companies were finding it difficult to resolve assets they had bought from banks.
- Therefore, they wanted to purchase the loans only on low prices.
- Consequently, banks were reluctant to sell them loans on a large scale.

- **IBC**: The Insolvency and Bankruptcy Code kicked off.
- The RBI announced a stringent loan resolution process through its circular.

Does the new scheme have safeguards against misuse?

- Yes, the RBI has built in safeguards in the resolution framework to ensure it does not lead to ever greening of bad loans.
- Restructuring of large exposures will need independent credit evaluation

done by rating agencies and a process validation by the expert committee.
- For personal loans there will be no requirement for third party validation by the expert committee, or by credit rating agencies, or need for ICA.
- The RBI has said that the term of loans under resolution cannot be extended by more than two years.
- In the case of multiple lenders to a single borrower, banks need to sign an Inter-Creditor Agreement (ICA).
- To mitigate the impact of expected loan losses, banks need to make a 10% provision against such accounts under resolution.
- For banks not willing to be part of the ICA, a penal provision of 20% has been specified.

What are the major differences with previous recast schemes?

- The earlier restructuring schemes did not have any entry barrier.
- The current scheme is available only for companies facing Covid-related stress, as identified by the cut-off date of March 1.
- Strict timelines for invocation of resolution plan and its implementation have been defined in the scheme.
- In the past, this was largely open-ended.
- Independent external evaluation, process validation and specific post-resolution monitoring are further safeguards.

Source: Indian Express